RIGHTS AND REMEDIES OF GENERAL CREDITORS OF MORTGAGED RAILWAYS

American railways, like English lands, are generally under mortgage, and they carry encumbrances amounting to billions of dollars. As *quasi* public corporations, they are under peculiar public obligations, and subject, therefore, to public regulation. Millions of people entrust their goods and persons to them for transportation, and multiplied thousands give them credit for millions of dollars annually in current dealing—almost of necessity. And when it is remembered that the directors and managers of these mortgaged arteries of commerce have the power for speculative purposes to precipitate foreclosure,[1] as well as that receiverships often follow naturally in the wake of misfortune, it is a subject of general concern, whether against an unwilling or hostile manager, receiver, trustee or bondholder, those, who have given the company credit, and parted with their property or rendered service on faith of its business as a going concern, and for the benefit alike of mortgagor and mortgagee, have any substantial security for their just claims.[2]

The question is also of practical interest to connecting carriers with traffic balances, and persons injured by the culpable negligence of the company.

(A)—General Features of Modern Railway Mortgages.

A preliminary statement of the leading provisions of modern railway mortgages will facilitate an understanding of the cases pertinent to the present inquiry. The usual form is a conveyance by deed of trust, in the most comprehensive terms, of all franchises and property of the company, including rights-of-way, roadbeds and superstructures, depots, machine shops and station houses, rolling stock and equipments, and moneys and credits—in a word, all property, real, personal and mixed—owned or to be acquired. The deed rarely contains specific descriptions of the property conveyed, other than an enumeration of its general classes. The mortgage period usually covers several decades.

[1] Failure to pay interest for three or six months usually brings to immediate maturity the entire principal.

[2] Lurton, J.. in *Fragin v. Railway Co.*, 88 Tenn., 165.

By express provision or plain implication, the mortgagor is permitted to retain possession of the property conveyed until default shall have been made in the payment of interest or principal of the mortgage-bonds; upon such default the mortgagee is authorized to enter and take possession of the railways conveyed, including all rolling stock, equipments and earnings, or to apply to a court for a receiver.

Since the mortgagor remains in possession, he must operate the road; otherwise, its value would be greatly impaired and its franchises lost through forfeiture to the State. Operation necessitates expense; expense requires payment; and, notwithstanding its conveyance of all moneys, possessed or to be acquired, the mortgagor is permitted to pay current expenses out of current income. Rolling stock becomes worn out and is broken, and the mortgagor is empowered to purchase other cars and engines in renewal or addition. Increasing traffic requires additional equipment and often necessitates the addition or extension of tracks; and the mortgagor is permitted to use earnings for these purposes. Without further illustration, the general rule is that, notwithstanding the mortgage purports to assign "all moneys, tolls, incomes, rents and profits," the mortgagor may use its earnings, in his own discretion, for payment of operating expenses, for ordinary and extraordinary repairs of rolling stock and equipments, for maintenance and extension of roadbeds and tracks, and for the purchase of such realty and personalty as he deems necessary and convenient for the conduct of its business. In apparent violation of the provisions of the mortgage, but in keeping with its spirit and purpose and uniform usage under such contracts, the mortgagor may divide the earnings from all connection with the mortgage-security by using them to pay dividends upon its stock, or for any purpose he pleases; and as long as interest is paid upon the mortgage debt, the mortgagee has no cause for complaint.[3] Thus it is seen that a railroad mortgage differs from most others; first, in that it contains no specific description and enumeration of the property assigned; second, in that property subsequently acquired by the mortgagor will enure to the benefit of the mortgagee; and, third, that the mortgagor is permitted to exercise over a part of the property conveyed all the rights and powers of an absolute owner.

[3] *Cowdrey v. Galveston R. R. Co.*, 11 Wall., 459; *Fosdick v. Schall*, 99 U. S., 235, and cases cited; and *vide post* (*B*), *I.*, 3.

It is unnecessary to remind the reader that the usual rule is that the property constituting the mortgage-security must be described with reasonable certainty; and that a sale or mortgage of property to be afterwards acquired is merely an executory contract, for the breach of which the law gives only an action for damages, and which equity will specifically enforce only for special reasons presented by the particular case.[4] And it is clear that permitting the mortgagor to exercise the powers left with the railroad company in possession would render most other mortgages fraudulent and void.[5] For reasons of public exigency and policy, these rules are waived by courts of equity in favor of railroad companies, and they are permitted to mortgage their "entire undertaking." The chief difference between railroad mortgages and other mortgages is based upon the fact that other mortgages merely hypothecate certain specific articles, which remain constant in kind and quality, while a railroad mortgage is the pledge of a venture, the assignment of *"a going concern"*—a changing and growing security.[6] Roadbed and superstructure, realty and fixtures, rolling stock and equipments, income and earnings, are not regarded merely as so much land, so many chattels and such sums of money, but as parts of an entirety, the undertaking or venture, which constitutes the real security—just as a bottomry bond is a mortgage of the ship and voyage, not merely of so many planks and beams, masts and sails, money in the ship's purse and freights to be earned. This difference between railroad and other mortgages will afford a key to the easy solution of many questions, which otherwise seem difficult. Property subsequently

[4] See *Phelps v. Murray,* 2 Tenn., Ch. 746, wherein the entire subject is discussed by Chancellor Cooper with his usual fullness of learning and all the authorities are reviewed.

[5] *Phelps v. Murray, supra; Tenn. Nat'l. Bk. v. Ebbert,* 9 Heisk., 153; *McCrossley v. Hasslock,* 4 Bax., 1; *Bank of Rome v. Hazelton,* 15 B. J. Lea, 216; *Robinson v. Elliott, 22* Wall., 513.

[6] *Burnham v. Bowen,* 111 U. S. 776. This is well expressed by Lord Cairns: "The undertaking is made the subject of a mortgage in this sense, that it is made over as a thing complete, or to be completed, as a going concern,—as a fruit-bearing tree, the produce of which is the fund dedicated by the contract to secure and to pay the debt. This living and going concern must not be broken up, or destroyed. *Garner v. London, Chatham & Dover R. R. Co.,* 36 L. J., Ch. 323. This apt description is more applicable to American mortgages, which cover all the property and earnings of the railway, than English debentures, which cover only the earnings.

acquired by the company passes to the mortgagee, not merely by virtue of the mortgagor's contract, for in that case there would be no difference in the mortgagee's relation to after-acquired realty, rolling stock and earnings—but because such after-acquired property becomes, and only in so far as it becomes, a portion of the undertaking—a part of the venture.[7]

(B)—RIGHTS BEFORE RECEIVER APPOINTED.

1. *Rolling Stock and Equipments*—Engines and cars, machinery and tools, and material and supplies are necessary parts of a railway. Operation is impossible without them; traffic could not be conducted; fares and freight could not be earned; and franchises could not be preserved. They are inseparable parts of the "going concern" and indispensable adjuncts of the venture. Therefore, as soon as acquired they pass under the mortgage and attach to the security.[8] The mortgagee's right to them is even superior to the claim of the company's vendor for the pur-

[7] By this it is not necessarily meant that after-acquired property will pass under a mortgage which merely conveys *the* undertaking, though this is the view taken in many cases: *Dinsmore v. Racine & Miss. R. R. Co.*, 12 Wis., 649, 656; *Farmers' Loan & Trust Co. v. Commercial Bank*, 11 Wis., 207, 212; *Phillips v. Winslow*, 18 B. Mon., 431; *Ludlow v. Hurd*, 1 Dis. (Ohio), 552; *Pierce v. Emery*, 32 N. H., 484; and seems to have the approval of Judge Redfield; 2 Redf., Railways, 501, N., 26. Whether or not these cases are sound, certainly, a mortgage of all property, including earnings, owned or to be acquired, is in the strictest sense a mortgage of the undertaking. See *Central Trust Co. v. Chattanooga, etc., R. Co.*, 94 Fed., 275.

[8] By some courts it is held that rolling stock passes to the mortgagee as accessions to the realty, upon the principle of accretion: *Farmers' Loan & Trust Co. v. St. Joseph & Denver City Ry. Co.*, 3 Dill., 412; *Minnesota Co. v. St. Paul Co.*, 2 Wall., 609; *Palmer v. Forbes*, 23 Ill., 301, 302; *Hunt v. Bullock*, 23 Ill., 320; *Titus v. Mabee*, 25 Ill., 257; *Titus v. Ginheimer*, 27 Ill., 462; *Gue v. Tidewater Canal Co.*, 24 How., 257; *Youngmann v. Elmira & Williamsport R. R. Co.*, 65 Pa. St., 278; *Shamokin Valley R. R. Co. v. Livermore*, 47 Pa. St., 465; *Susquehanna Canal Co. v. Bonham*, 9 Watts, 27; *Macon & Western R. R. Co. v. Parker*, 9 Ga., 377; *Williamson v. N. J. Southern R. R. Co.*, 29 N. J. Eq., 311. Other cases regard rolling stock, not as accessions to the realty, but as personalty, which passes under the mortgage as after-acquired chattels. *Farmers' Loan & Trust Co. v. Hendrickson*, 25 Barb., 484; *Stevens v. Buffalo & N. Y. R. R. Co.*, 31 Barb., 590; *Beardsley v. Ontario Bk.*, 31 Barb., 619; *Randall v. Elwell*, 52 N. Y., 521; *Coe v. C. P. & I. R. R. Co.*, 10 Ohio St., 372; *Boston, Concord & Montreal R. R. Co. v. Gilmore*, 37 N. H., 410.

chase price.[9] The general creditor cannot subject them to the payment of his debt, because they are necessary parts of the undertaking, which was mortgaged before his debt was created;[10] and if the general creditor seeks to levy upon or attach them, equity, at the suit of the mortgagee, will preserve by injunction the indispensable means of continuing the operation of the road.[11] If, however, the company purchases rolling stock to an amount in plain excess of the requirements of the road, the excess becomes subject to levy by the general creditor.[12] Coal, wood and oil are parts of the undertaking, since engines cannot be run without fuel, and cannot be subjected to the satisfaction of a floating debt.[13] So are tools, apparatus and materials, for railroads cannot be operated without repairs.[14] Safes, chairs, desks, stationery and other office furniture, *suitable in kind and of a necessary amount,* are necessary to the operation of the road and not subject to levy at the suit of a general creditor.[15] The mortgage attaches to rails, purchased for the purpose of repairing or extending the track, as soon as purchased, and the mortgagee may restrain by injunction the company from selling or pledging them.[16] Cast-off articles, such as broken wheels, rails and ties, once forming a part of the road or used in its operation, remain subject to the lien of the mortgage, *if a proper management of the road require that they should be repaired, recast or exchanged* for new articles.[17] And the mortgage will cover a majority of the stock of a connecting road, *purchased to secure a consolidation,* such acquisition not differing in principle from an extension of the line of the mortgagor.[18]

There are many cases which place the rights of the mortgagee to subsequently acquired chattels alone upon the express terms of the mortgage. But such holdings are opposed to the well-settled rule that no contract can at law pass an interest in sub-

[9] 2 Redf., Railways, 507.

[10] *Shaw v. Bill,* 95 U. S., 10; *Pennock v. Coe,* 23 How., 131.

[11] *Butler v. Rahm,* 46 Md., 541.

[12] *Ludlow v. Hurd,* 1 Dis., 552.

Cas., No. 4,149.

[13] *Phillips v. Winslow,* 18 B. Mon., 43, 44; *Dunham v. Earl,* 8 Fed.

[14] *Phillips v. Winslow, supra.*

[15] *Ludlow v. Hurd, supra.*

[16] *Weejen v. St. P. & Pacific R. R. Co.,* 4 Hun (N. Y.), 529.

[17] *Cooper v. Wolf,* 15 Ohio St., 523; *Buck v. Seymour,* 46 Conn., 156.

[18] *Williamson v. N. J. Southern R. R. Co.,* 26 N. J. Eq., 398.

sequently acquired chattels and that equity will enforce agreements for the sale or mortgage of chattels acquired after the contract only in particular cases and for special reasons. The cause of the exception in favor of railway mortgages is that public policy favors the construction and operation of railways; and, therefore, permits the company, as a means of securing credit for the cost of construction and equipment, to mortgage the entire undertaking, with all its aids and incidents. But the very reason of the exception suggests its proper limitation to such chattels as, by fair application of a liberal rule, may be considered as helps in maintaining the road as "a going concern."

2. *Realty and Structures.*—All lands used for road-beds, station-houses, depots, machine shops and other necessary or convenient structures, or acquired for such purposes, are parts of the railroad, "the undertaking made over as a thing complete, or to be completed."[19] So new lines acquired by construction,[20] extension,[21] lease,[22] or purchase,[23] pass at once under the mortgage. But woodland, lying off the line of road, though purchased as a source of fuel, does not pass to the mortgagee and is subject to levy by a general creditor.[24] And town lots having no connection with the road and its operation, cannot be claimed by the mortgagee and can be taken to satisfy a floating debt.[25] Nor can the mortgagee claim lands bought by the company when securing its right of way "to avoid dissevering a tenement," though the purchase price was a part of the fund advanced by the mortgagee.[26] Nor does the mortgagee take a "land grant" subsequently acquired by the mortgagor, when the mortgagor had no charter power to acquire such a grant at the date of the execution of the mortgage.[27] It is otherwise where the land was granted as an inducement to the construction of the road, for in such case the land grant is the very trunk of "the fruit-bearing

[19] *Hamlin v. European, etc., R. Co.*, 72 Me., 83; *Boston, etc., R. Co. v. Coffin*, 50 Conn., 150; *Shaw v. Bill*, 95 U. S., 10.

[20] *Galveston R. R. Co. v. Cowdrey*, 11 Wall., 459.

[21] *Dunham v. Cincinnati, Penn. & Chicago R. R. Co.*, 1 Wall., 254.

[22] *Barnard v. Norwich & Worcester R. R. Co.*, 3 Cent. L. J., 608.

[23] *Williamson v. N. J. Southern R. R. Co.*, 26 N. J. Eq., 398.

[24] *Dinsmore v. Racine & Miss. R. R. Co.*, 12 Wis., 649.

[25] *Shamokin Valley R. R. Co. v. Livermore*, 47 Pa. St., 465; *Calhoun v. Memphis, etc., R. Co.*, 4 Fed. Cas., No. 2,309.

[26] *Gardner v London, Chatham & Dover R. Co.*, 36 L. J. Ch. 323.

[27] *Meyer v. Johnston*, 53 Ala., 237.

tree."[28] The general rule, which, because, of the special form of particular mortgages, may not always apply, is that lands acquired by the company for any other than railway purposes will not pass under the mortgage.[29]

3. *Tolls and Income.*—The right of a general creditor of a railroad company in possession to impound the earnings of a mortgaged railway has been the subject of widely divergent opinions, but is now settled by the great preponderance of best authority, including the Supreme Court of the United States.

(*a*) There is a class of cases represented by *Buck v. Memphis & Little Rock Railroad Company*[30] and *Pullan v. Cincinnati & Chicago Air Line Railroad Company,*[31] in which it is held that the mortgage attaches to the tolls and income as soon as earned and that the general creditor can acquire no right to or lien upon them. Such cases place earnings upon the same footing as rolling stock, ignoring the distinction that income when earned ceases to have any necessary connection with the operation of the road, and that the company, before the appointment of a receiver, has the right to use its income as it chooses. These cases would not now be followed anywhere, except possibly in Iowa, whose court seems wedded to its iniquity.[32]

(*b*) Another class of decisions is to the effect that the mortgage attaches to the income as soon as the amount of net earnings, after the payment of operating expenses is ascertained. *Parkhurst v. North Carolina Railroad Company*[33] and *Clay v. E. T. V. & G. R. R. Co.*[34] will serve for illustration. These cases, while properly taking into account the fact that the mortgagor in possession must pay current expenses out of current income, overlook the further fact that the mortgagor before default can use income, both gross and surplus, as it chooses, and that retention of net income is not necessary to a continuance of the undertaking. Moreover, the rule is open to the practical objection that a railroad company has at all times a large

[28] *Campbell v. Texas & N. O. R. R. Co.*, 2 Woods, 263.

[29] *Seymour v. Canandaigua & Niagara Falls Railway*, 25 Barb., 284; *Pardee v. Aldridge*, 189 U. S., 429.

[30] 4 Cent. Law Journal, 430.

[31] 5 Biss., 287.

[32] *Jessup v. Bridge Co.*, 11 Iowa, 572; *Dunham v. Issett*, 15 Iowa, 284.

[33] 19 Md., 472.

[34] 6 Heisk., 421. See, also, *Spies v. Chicago, etc., R. Co.*, 40 Fed. Rep., 34.

amount of contingent liabilities and that the exact amount of net earnings can at no time be definitely ascertained.

(*c*) The true rule has been well expressed by Judge Swayne:[35] "Possession draws after it the right to receive and apply the income. Without this, the road could not be operated and no profits could be made. Mere possession would have been useless to all concerned. The right to apply enough of the income to operate the road will not be questioned. The amount to be so applied was within the discretion of the company. *The same discretion extends to the surplus.* It was for the company to decide what should be done with it. In this condition of things the whole fund belonged to the company and was subject to its control. It was, therefore, liable to the creditors of the company as if the mortgage did not exist. They were in no wise affected by it."

This ruling has been repeatedly followed in that court in later cases[36] and, being the settled opinion of our highest tribunal, should conclude the question, even if it were not supported by the best considered decisions of other courts.[37]

If a specific sum is set apart as interest or sinking fund of the mortgage bonds, it has been held that it thereby ceases to be subject to the claim of a general creditor;[38] and it seems, upon principle, that this would be such an appropriation of particular chattels to the executory contract as would execute it and pass property. But, it has been held, even when the treasurer turned over money to the mortgagee upon possession taken by him after default that the general creditor might follow the fund in the hands of the mortgagee and subject it to the payment of his debt.[39]

From a review of the decisions it will appear that, while there have been wide differences of opinion between the courts and

[35] *Gilman v. Illinois & Miss. Telegraph Co.*, 91 U. S., 603.

[36] *Galveston R. R. Co. v. Cowdrey*, 11 Wall., 459; *American Bridge Co. v. Heidelbach*, 94 U. S., 798; *Fosdick v. Schall*, 99 U. S., 235, and cases cited: *Burnham v. Bowen*, 111 U. S., 776; *Louisville Tr. Co. v. Louisville, etc., R. Co.*, 174 U. S., 674.

[37] *Smith v. Eastern R. R. Co.*, 124 Mass., 154; *Ellis v. Boston, Hartford & Erie R. R. Co.*, 107 Mass., 1; *Bath v. Miller*, 53 Me., 308; *Noyes v. Rich*, 52 Me., 115; *Merchants' Bank v. Petersburg R. R.*, 34 Leg. Int., 240; *Miss. Valley R. R. Co. v. U. S. Express Co.*, 81 Ill., 534.

[38] *Galena & Chicago Union R. R. Co. v. Menzies*, 26 Ill. 121.

[39] *DeGraff v. St. Paul & Pacific R. R. Co.*, 5 Fed Rep., 561.

even in the same court in different cases, the relative rights of bond holders and general creditors of mortgaged railways, before possession has been taken by the mortgagee or a receiver appointed at his instance, have been fixed by practical concurrence of the more authoritative tribunals.

(C)—After the Appointment of a Receiver.

The questions as to effect of the appointment of a receiver, or an entry after default by the mortgagee, present more difficulty. The cases are in irreconcilable conflict. The principles announced by different courts, and in some instances by the same court in successive cases, are strangely repugnant. In the space allotted it is impossible to discuss all the decisions. Merely to cite them would be of small advantage. Only such will be noticed as will serve to illustrate the different views upon the subject and to place the reader who desires to make further inquiry upon the path of investigation.

The decisions can be grouped into four general classes:

1. *Cases Holding the Mortgage Superior to All Floating Debts.* —*Dunham v. Cincinnati, Peru and Chicago Railroad Company*[40] was a contest between a contractor who had built a portion of the railway and the mortgagee. Notwithstanding the fact that the railroad company had agreed with the contractor that he should retain possession of the road built by him until the earnings paid his claim, the court treated him as a second encumbrancer and gave the entire proceeds of the road to the prior mortgagee. Mr. Justice Clifford says: "Registration of the first mortgage was notice to all the world of the lien of complainant; and, in that view, the case does not even show a hardship upon the contractor." And Mr. Jones says in beginning his discussion of this subject: "At the outset it is proper to state as a settled legal principle that *a fixed legal right* cannot be impaired by any equities subsequently arising.[41] But the author had, for the moment, forgotten that the mortgagee has no *legal claim* whatever to after-acquired property. Such rights are entirely equitable, deriving their existence from equitable principles, depending for protection and enforcement upon equitable remedies, and subject to equitable restrictions and limitations. And Mr. Justice Clifford,

[40] 1 Wall., 254.

[41] Jones, *Railroad Securities*, 557.

in placing his decision upon the naked provision of a registered contract, fails to note that, while the contractor had notice of a mortgage which would mature in twenty years, he had no notice that the railroad company would be deprived of possession almost immediately. The case illustrates the monstrous injustices which would follow upon the enforcement of the rule it declares. That the entire proceeds of property created by the money and labor of another may be taken, without any compensation whatever, is a result no one would expect to follow upon the application of equitable principles. Furthermore, this decision is opposed to the well-settled rule that, though the mortgage attaches to property subsequently acquired by the company, it is subject in the hands of the mortgagee to all the requirements of the contract by which it was acquired by the mortgagor.[42] And it is in direct conflict with the decision in *Dunham v. Cincinnati, Peoria & Chicago Railway.*[43]

2. *Cases Wherein the Court Has Allowed Certain Floating Claims, the Payment of Which Tended to Preserve the Mortgage-Security.* In *Douglass v. Cline,*[44] the court ordered the receiver to pay balances due to employees of the company at the date of his appointment, for the reason that withholding payment might result in discontent and cessation of work by employees and a consequent suspension of the operation of the road. The court said: "It was the duty of the chancellor to allay this discontent, and to assist his receiver in securing the services of these people, and thus to secure the profitable management and operation of the road in his hands." The opinion of the majority of the court places the allowance of such claims upon the ground that it was necessary to preserve the trust property from injury and expressly distinguishes such claims from other general or floating debts of the company. For the same reason the Supreme Court of the United States ordered the receiver to pay traffic and freight balances due from the company to other connecting railroads, the court saying through Mr. Justice Blatchford:

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[42] *Southern Ry. Co. v. Ensign Manuf. Co.,* 117 Fed. Rep., 417; *Galveston R. R. Co. v. Cowdrey,* 11 Wall., 459; *U. S. v. N. O. R. R. Co.,* 12 Wall., 362; *Wilbuk v. Norris Canal Co.,* 3 Green, N. J. Ch. 377; *Williamson v. N. J. Southern R. R. Co.,* 28 N. J. Eq., 298; S. C., 29 Id., 311; *Meyer v. Johnson,* 53 Ala., 352.

[43] 13 Railway Times.

[44] 12 Bush., 608.

"The payment of limited amounts due to other and connecting lines for unpaid ticket and freight balances, and for materials and repairs, the outcome of indispensable business relations, where the stoppage of a continuance of such business relations would be a probable result in case of non-payment, may well place such payments in the category of payments to preserve the mortgaged property in a large sense by maintaining the good will and integrity of the enterprise."[45]

This rule is indisputably correct as far as it goes, for it is a general principle that a trustee or receiver may make, and courts of equity will order made, all expenditures which are necessary to preserve the subject-matter of the trust or receivership from injury.[46] The objection to the rule is that it is too narrow; it considers only the rights and interest of the mortgagee. It pays no regard to the fact that the mortgagor was left in possession, charged with the duty of operating the road, with power to pay expenses of operation out of income; and the necessary corollary of this proposition is that operating expenses constitute prior charges upon the earnings of the road. And as shown by Judge Cofer in the dissenting opinion in *Douglass v. Cline, supra,* the rule is too indefinite for practical guidance. "In a large sense," every debt contracted by the company, in the legitimate exercise of the powers left it by the mortgagee, has relation to the preservation of the value of the security, since it aids in the equipment or forms part of the operation of the road; and payment of all floating debts may be said to tend to preserve the value and "integrity of the enterprise," since neither persons nor corporations can retain the good will of the public without paying their debts. In practice, however, the courts have undertaken to say, upon purely arbitrary reasons, that certain payments would, and others would not tend "to insure the continued value of the enterprise." These cases cannot be reconciled with each other, nor with any equitable principle. The rule sought to be established by this class of opinions leaves the relative rights of mortgage and general creditors to be measured by the "crooked chord of judicial discretion," and not by "the golden mete-wand of the law."

3. *Cases Allowing Floating Claims Accruing Within a Certain Period Before the Receivership.*—In *Union Trust Co. v. Souther*

[45] *Miltenberger v. Logansport & C. R. R. Co.,* 106 U. S., 286.

[46] 2 Perry, on *Trusts,* Sect. 910.

the court ordered the receiver to pay all claims contracted by the company within six months next before his appointment.[47] In *Fosdick v. Schall* all floating debts accruing within three months before the receivership were ordered paid.[48] And so in *Miltenberger v. Logansport, &c., R. R. Co.,* payment was ordered of all debts incurred by the company within ninety days before the receiver was appointed.[49] It is manifest that this is judicial legislation, pure and simple, all the more arbitrary and unjust because retrospective. It has not even the virtue of certainty, the usual advantage of arbitrary rules, since the courts adopt in each case such period as they please without regard to former practice.

4. *Cases Allowing All Claims Contracted by the Mortgagor as Parts of the Current Expenses of Operating the Road.*—It has been seen from the foregoing cases that the adjudications do not present the familiar aspect of the development of a new branch of law by the gradual growth of a persistent principle; but to the contrary, the decisions rest upon opposed and contradictory reasons, thus evincing judicial dissatisfaction with the grounds of former opinions. It remained for Mr. Chief Justice Waite to declare a rule, which embraces the entire subject, pays equal regard to the rights of mortgage and general creditors, will bear criticism and sustain analysis because closely evolved from the character of the contract, and will uniformly enforce equity, because it holds the mortgagee to the results which just and intelligent men would have contemplated in making the agreement. The reasoning by which the true rule was reached can be thus briefly stated: In permitting the mortgagor to remain in possession, the mortgagee intended it should operate the road; operation necessitates expense; power to incur expense carries with it the power to make payment; current income, though expressly included in the mortgage, must be used in defraying current costs of operation; holding the parties to the necessary results of their contract, the court will declare current expenses a prior and paramount charge upon current income; but the operation of a railroad requires at times expenditures in excess and anticipation of the income; therefore, it is not sufficient that current income for any period should be applied to current expenses within that period; but, in the view of a court of equity,

[47] 107 U. S., 591.
[48] 99 U. S., 235.
[49] 106 U. S., 286.

debts incurred in the operation of the road are a continuing charge upon the earnings of the road. These propositions establish the relative *rights* of the holders of mortgage-bonds or debentures and general or floating debts of the company; and a court, when its equitable aid is invoked by the mortgagee, will avail itself of the flexibility of equitable forms to adapt the *remedies* of the various classes of creditors to the conveniences afforded by the special facts of the particular case.

Fosdick v. Schall[50] was an application by a general creditor for an order for the payment by the receiver of rental upon cars leased to the company; and the court, through Mr. Chief Justice Waite, said:

"Railroad mortgages and the rights of railroad mortgagees are comparatively new in the history of judicial proceedings. They are peculiar in their character and affect peculiar interests. * * * The business of all companies is done to a greater or less extent on credit. This credit is longer or shorter as the necessities of the case require; and when the company becomes pecuniarily embarrassed, it frequently happens that debts for labor, supplies, equipments and improvements are permitted to accumulate in order that bonded interest may be paid and a disastrous foreclosure be postponed, if not altogether avoided. In this way the daily and monthly earnings, which ordinarily should go to pay daily and monthly expenses, are kept from those to whom in equity they belong, and used to pay the mortgage debt. * * * Every railroad mortgagee in accepting his security impliedly agrees that the current debts made in the ordinary course of business shall be paid from the current receipts before he has any claim upon the income. If for the convenience of the moment something is taken from what may not improperly be called the current debt fund, and put into that which belongs to the mortgage creditors, it is certainly not inequitable for the court, when asked by the mortgagees to take possession of the future income and hold it for their benefit, to require that what is due from the earnings to the current debt shall be paid by the court from the future current receipts before anything derived from that source goes to the mortgagees. * * * This, not because the creditors to whom such debts are due have in law a lien upon the mortgaged property or income, but because in a sense the officers of the company are trustees of the earnings for the benefit of the different classes of creditors and stockholders; and if they give to one class that which properly belongs to another, the court may, upon an adjustment of the accounts, so use the income which comes into its own hands as, if practicable,

[50] 99 U. S., 235.

to restore the parties to their original equitable rights. * * * It follows that if there has been in reality no diversion, there can be no restoration; and the amount of the restoration should be made to depend upon the amount of the diversion."

Burnham v. Bowen[51] was an application for payment by the company's vendor of coal. Mr. Chief Justice Waite again delivered the opinion of the court and expressly confirms the holding in *Fosdick v. Schall,* saying: "We think the debt was *a charge in equity upon the continuing income* as well that which came into the hands of the court after the receiver was appointed as that before."

All our courts should follow the established rule of the most eminent and authoritative of American tribunals. Thus three propositions, practically embracing all questions which can arise between mortgagees and general creditors, will be made definite and certain:

First—Debts, contracted by the mortgagor in possession as a part of the expense of operating the road, are prior charges upon the earnings of the road and must be paid before interest or principal of the mortgage debt;

Second—Such debts are a continuing charge upon the earnings of the road;

Third—The right of the mortgagee to property acquired by the mortgagor after the mortgage, and to future earnings, becomes fixed by the appointment of a receiver; and in order to reach the earnings of the road pending the receivership, by invoking the equity of marshalling assets, or to subject the *corpus* of the mortgage-security to the payment of the floating debt, upon the principle of following a fund into its investment, the general creditor must show a diversion, made for the benefit of the mortgagee, of current earnings from the payment of current expenses.

What are current expenses of operation, within the meaning of this rule, has not been judicially defined, except by adjudging that particular classes of claims fell within the principle. From the cases above cited and for obvious reasons it seems plain that debts due for supplies, labor, equipments, repairs and improvements, and as freight and ticket balances are within the rule. A liability of the company on account of stock killed is a "running

[51] 111 U. S., 776.

expense."[52] Claims for injuries to persons and property, occurring pending the operation of the road by a receiver, are ordered paid out of his earnings, upon the theory that such liabilities are necessary incidents of operating a railroad.[53] And it seems that they would, equally and for the same reason, be elements of the current expenses of operating the road by the mortgagor. It could hardly be insisted that incurring liability as damages for injuries to property was not a necessary incident of operating a railway, in the face of the fact that no road was ever run without such liabilities, or that the duty to make compensation for personal injuries was not a part of running expense, because such injuries are not necessary incidents of the operation of the road, in view of the fact that over ten thousand persons have been killed or injured in the operation of the railways of the United States within a single year.[54]

The reason of the rule requires that operating expenses shall include every source of liability usually incident to the operation of a railway, or in the words of Chief Justice Waite, "all current debts made in the ordinary course of business."[55]

(D)—Remedies of General Creditors.

1. *Before Receivership.*—If rolling stock is purchased by the company in plain excess of the requirements of the road, it is subject to levy at the suit of a general creditor;[56] and so is after-acquired realty, which has no connection with the operation of the road.[57] If the mortgagee makes unreasonable resistance to the payment of the general creditor, or inequitably interposes for delay, equity will permit a sale of sufficient rolling stock to satisfy the demand.[58] Where the distinction prevails as to the mortgagee's right to gross and net income, the general creditor's remedy is a bill for an account.[59] A receiver will be appointed to take possession of and operate the road at the suit of a creditor of the

[52] *Lane v. Baughman,* 17 Ohio St., 642.

[53] *Little v. Dusenberry,* 46 N. J. Law, 614; *Meara v. Holbrook,* 20 Ohio St., 137; *Newell v. Smith,* 49 Vt., 255; *Cowdrey v. Galveston, etc., R. R. Co.,* 93 U. S., 352; *Paige v. Smith,* 99 Mass., 395.

[54] Compendium of Twelfth Census, Vol. 2, p. 1267.

[55] *Burnham v. Bowen, supra.*

[56] *Ludlow v. Hurd, supra (B), I.,* 1.

[57] *Supra (B), I.,* 2.

[58] *Pennock v Coe,* 23 How., 131.

[59] *Clay v. E. T. V. & G. R. R. Co.,* 6 Heisk., 421.

company; the mortgagee need not be made a party to such a suit; and in such a case, the mortgagee is not entitled to the earnings of the receivership.[60] If an execution or attachment can be levied upon the money of the company, it may be—for money is as much subject to levy as any other chattel.[61] But such levies will be found to be accompanied with practical difficulties. Garnishment or trustee process will afford the speediest and most efficacious remedy.

In this way ticket and freight balances due from other companies and individuals can be reached;[62] but not funds in the hands of the treasurer or station agents of the company, for their possession is that of the company, and the execution debtor cannot be made a garnishee for his own debt.[63] Of course, the entire equitable interest of the company, like that of any other mortgagor, may be sold for debt; and the purchaser takes the road and appurtenances *cum onere*.[64]

2. *Pending the Receivership.*—The court in the order appointing a receiver for a railway should impose such terms for the payment of the floating debts of the company as, under the circumstances of the particular case, appear to be reasonable; but if this is not done, and it appears in the progress of the cause that earnings have been used to pay mortgage debt or to make improvements, leaving operating expenses unpaid, the court will order payment out of the earnings of the receiver.[65] The decree of foreclosure or order of sale should protect the rights of creditors holding claims superior to the mortgage, either by reserving a sufficient amount from the proceeds of the sale or by providing that the purchaser take the road *cum onere* of such claims, After an order for the receiver to take possession of the road, its property ceases to be subject to levy of creditors and no

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[60] *Miltenberger v. Logansport & C. R. R. Co.*, 106 U. S., 286; *American Bridge Co. v. Heidelbach*, 94 U. S., 798.

[61] *Dalby v. Mullins*, 3 Hun., 437; *sed.* cf., *Turner v. Fendall*, 1 Cranch, 118.

[62] *Smith v. Eastern R. R. Co.*, 124 Mass., 154; *Ellis v. Boston, H. & E. R. R. Co.*, 107 Mass., 1; *Bath v. Miller*, 51 Me., 308; *Noyes v. Rich*, 52 Me., 115.

[63] *Pettingill v. Androscoggin R. R. Co.*, 51 Me., 370; *Fowler v. P. W. & C. R. R. Co.*, 35 Pa. St. 22; *Pullan v. C. & C. A. L. R. R. Co.*, 5 Biss., 237.

[64] *Miltenberger v. Logansport & C. R. R. Co.*, 106 U. S., 286.

[65] *Fosdick v. Schall, supra; Burnham v. Bowen, supra.*

proceedings can be had against it without permission from the court appointing the receiver.[66]

A general creditor seeking payment of his claim should intervene by petition for examination *pro interesse suo* in the cause wherein the receiver was appointed.[67]

This paper is based chiefly upon principles of the common law and doctrines of equity, as applicable in ordinary cases. The rights and remedies herein supported may be materially varied in some instances by the special form of particular mortgages, or local statutory provisions prescribing the effect of railway mortgages.

Henry H. Ingersoll.

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[66] *De Groff v. Jay,* 30 Barb., 483; *Angel v. Smith,* 9 Ves., 335; *Boston v. Barbour,* 104 U. S., 726; *Thompson v. Scott,* 4 Dill., 504.

[67] 19 Am. Law Review, 420 *et seq.*